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IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

HAROLD M. PROVIZER and JOAN PROVIZER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the penalty provided by Section 6659 of the Internal Revenue Code of 1954 for an underpayment of tax that "is attributable to a valuation overstatement" can be imposed even when the underpayment of tax rests upon grounds that are wholly independent of any overvaluation statement, *viz.*, that the transaction lacked economic substance and the equipment in question was not placed in service during the taxable year in which the tax credits were claimed.

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COMMISSIONER OF INTERNAL REVENUE

Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITION FOR A WRIT OF CERTIORARI

Harold M. Provizer and Joan Provizer petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, pp. 1a-6a) is not officially reported. The memorandum findings of fact and opinion of the Tax Court (App., *infra*, pp. 7a-62a) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on July 7, 1993. By order dated September 24, 1993, Justice Stevens extended the time within which a petition for a writ of certiorari could be filed to and including

December 4, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

The provisions of Section 6659 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at App., *infra*, pp. 63a-64a.

STATEMENT

This federal income tax case presents the question whether the Commissioner of Internal Revenue can impose the valuation overstatement penalty provided by Section 6659 of the Internal Revenue Code even when the underpayment in tax stands on grounds that are wholly independent of any valuation overstatement.

The pertinent facts can be summarized as follows: During the taxable year 1981, petitioner Harold M. Provizer [1] invested $8,333 to purchase a 16.67 percent interest in a general partnership known as DL and Associates, which in turn invested $50,000 to acquire a 6.188 percent limited partnership unit in a New York limited partnership known as the Clearwater Group. Clearwater was formed to engage in the business of leasing, as lessee, and thereafter licensing, as licensor, six Sentinel EPE Recyclers. These machines were specially designed to recycle low density polyethylene scrap and thereby enable plastics manufacturers to purchase less expensive raw material than newly-processed oil-based resin (App., *infra*, pp. 2a, 24a; R. 31: Tr. 121-122, 315-316).[2] Prior to investing in Clearwater, petitioner consulted with various profes-

[1] Joan Provizer is a party to this proceeding solely because she filed a joint federal income tax return with her husband for the taxable year at issue (App., *infra*, p. 12a).

[2] "R." references are to the joint appendix filed in the court of appeals. For the convenience of the Court, we are lodging a copy of Volume 6 of the joint appendix with the Clerk which contains the designated portions of the trial transcript.

sional advisors and persons familiar with the oil industry. Thereafter, petitioner concluded that the proposal had a good potential for economic profit because it was generally believed that the dramatic increase in the price of oil during 1976-1981 would continue. Since plastic resin prices are directly tied to the price of crude oil, continued increases in the price of oil would increase demand for recycled plastic material (R. 31: Tr. 1070-1074).

The recyclers were manufactured by Packaging Industries Group, Inc. ("PI"), a privately-held company based in Hyannis, Massachusetts. During 1981 (the taxable year at issue) and for several years thereafter, PI was one of the major manufacturers of thermoplastic and other types of packaging machinery. Through a series of transactions, the machines were sold by PI to another corporation, and ultimately leased under a "safe harbor" leasing arrangement [3] to the Clearwater Group, which then licensed the machines back to PI for sublicense to end-users who would use them to recycle plastic scrap. Supported by a tax opinion rendered by the major New York City law firm of Windels, Marx, Davies & Ives,[4]

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[3] Section 168(f)(8) of the Internal Revenue Code of 1954, in effect for the year at issue (1981), provided that if the parties to certain agreements known as safe-harbor leases met certain requirements, the agreement would be regarded as a lease for tax purposes. As a result, the designated lessor would be treated as the owner of the property and the designated lessee would be treated as the lessee of the property without regard to the economic substance of the transaction.

[4] The tax opinion was prepared by John Y. Taggart, a prominent tax lawyer in New York City. Taggart was the head of the tax department of Windels, Marx, Davies & Ives and taught tax law as an adjunct professor at New York University Law School. Prior to his entry into private practice, Taggart had served in the Office of Tax Legislative Counsel of the Treasury Department, as a full-time member of the faculty of the New York University Law School and as editor-in-chief of the Tax Law Review (App. *infra*, p. 15a). The accuracy of Taggart's legal opinion was also confirmed by Price Waterhouse (R. 31: Tr. 1006-1007). In the course of preparing the

petitioner claimed on his 1981 tax return an investment tax credit of $7,195, an additional business energy investment credit of $7,195, and a deduction of $6,668 that was attributable to his aliquot share of Clearwater's outlay for rent for the machines (App., *infra,* p. 2a).

On audit, the Commissioner of Internal Revenue determined a deficiency in petitioner's 1981 tax liability of $17,724 by disallowing all of his claimed credits and deductions attributable to his Clearwater investment on the ground that the Clearwater transaction was a sham. The Commissioner also assessed a 30 percent penalty for valuation overstatement equal to $4,317, and an additional negligence penalty of $866 plus 50 percent of the interest due on the deficiency (App., *infra,* pp. 2a-3a).

After a trial in the United States Tax Court before Special Trial Judge Norman H. Wolfe, the Tax Court rejected petitioner's contentions that his claimed tax benefits were protected from disallowance because the transaction qualified under the safe-harbor lease provisions. Instead, it concluded that the Clearwater transaction was a sham because it lacked economic substance and business purpose and disallowed the claimed deduction and credits (App., *infra,* pp. 40a-59a). The Tax Court also upheld the Commissioner's penalty determinations for valuation overstatement and negligence (App. *infra,* pp. 59a-61a). With respect to the valuation overstatement penalty, the Tax Court found that the value of the recycler machines was approximately $50,000, rather than the $1,162,666 price that the Clearwater Group paid for each of them. Without further analysis, the Tax Court upheld the penalty, concluding that "[p]etitioners'

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offering memorandum and tax opinion in the Plastic Recycling partnerships, the Windels firm undertook extensive efforts to verify PI's representations that the Recycler was unique. These efforts included Taggart's personal consultation of technical journals and other manufacturers' machine brochures (R. 31: Tr. 284, 304, 308, 316-317).

valuations are by definition overstated within the meaning of section 6659" (App., *infra*, p. 61a).[5]

On appeal, the court of appeals affirmed the Tax Court's decision in an unpublished *per curiam* opinion (App., *infra*, pp. 1a-6a). It first upheld the Tax Court's holding that petitioner was not entitled to the tax benefits he claimed on his return with respect to the Clearwater investment. In so ruling, the court stated that the transaction "was indeed a sham," which it defined as one that "has no economic substance" and "[one in which] the taxpayer did not engage . . . with any business purpose other than to generate tax benefits" (App., *infra*, p. 4a). As the court viewed the matter, "there was little opportunity for Clearwater to realize an economic profit from this transaction" (*id.*) because of the substantial price it paid for the machines. The court also based its decision on the fact that the general partner "had no experience in the plastics industry and devoted little time to managing the business activities of Clearwater" (App. *infra*, pp. 4a-5a).

The court of appeals further acknowledged that "two of the recyclers ostensibly leased by Clearwater were broken in 1981 and were never placed in service, and the machines that were put in service were used only sparingly" (App. *infra*, p. 4a). Despite this concession, the court nevertheless upheld the Commissioner's overvaluation penalty assessment even though the underpayment of tax was not "attributable to" any overvaluation statement within the meaning of Section 6659(a) of the Code but

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[5] Notwithstanding the evidence of petitioner's careful investigation and his good faith belief (consistent with the general expectation in December 1981) that the price of oil would continue to increase so as to confirm the economic soundness of the plastics recycling process, the court of appeals without any elaboration upheld the Tax Court's imposition of the negligence penalty (App., *infra*, p. 5a). However, on similar facts, the Tax Court has struck down the negligence penalty when the taxpayer demonstrated that his investment was prompted by the energy crisis in the late 1970s. *See Krause v. Commissioner*, 99 T.C. 132 (1992).

stood on independent grounds, *viz.*, that the transaction lacked economic substance and that the machines were not placed in service in 1981 (App., *infra*, p. 5a). In so ruling, the court did not address the conflicting decisions of two circuit courts of appeals and the Tax Court that have held that the Section 6659 overvaluation penalty cannot be imposed in such circumstances. *Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988) (property not placed in service); *Heasley v. Commissioner*, 902 F.2d 380 (5th Cir. 1990) (total disallowance); *Gainer v. Commissioner*, 893 F.2d 225 (9th Cir. 1990) (agreeing with *Todd*); *McCrary v. Commissioner*, 92 T.C. 827, 851-855 (1989) (total disallowance). Rather, the court followed its prior contrary decision in *Illes v. Commissioner*, 982 F.2d 163, 167 (1992), which it cited for the proposition that the Section 6659 penalty is applicable when the lack of economic substance is due to an overvaluation. In *Illes*, the court below had earlier endorsed the broad ruling adopted by the Eighth Circuit in *Massengill v. Commissioner*, 876 F.2d 616, 619-620 (1989), that "When an underpayment stems from disallowed depreciation deductions or investment credit due to lack of economic substance, the deficiency is attributable to overstatement of value, and subject to the penalty under section 6659."

REASONS FOR GRANTING THE PETITION

The decision of the court of appeals squarely conflicts with decisions of both the Fifth and Ninth Circuits with respect to the question whether the overvaluation penalty provided by Section 6659 of the Internal Revenue Code can be imposed when the underpayment in tax is attributable to grounds that are wholly independent of any overvaluation statement. Those courts have held that the penalty cannot be imposed in such circumstances. On the other hand, the Second and Eighth Circuits are aligned with the court below and have upheld the penalty whenever there is an overvaluation statement even in the absence of any directly proximate causative relationship between the overvaluation statement and the underpayment in tax.

The question of statutory interpretation upon which this case turns has substantial administrative importance. There are thousands of persons throughout the country who have claimed tax credits as a result of their participation in transactions that are virtually identical to the very investment involving the same equipment at issue in this case. Moreover, the fact that the Commissioner has thus far advanced his position in this case in four circuits suggests that there are many other cases pending administratively and in the courts involving other transactions in which the overvaluation penalty has been assessed in comparable circumstances. This Court should therefore grant certiorari to resolve the conflict among the various courts of appeals and establish a uniform national rule for the benefit of both taxpayers and the Internal Revenue Service.

1. a. Section 6659(a) of the Internal Revenue Code imposes a special penalty equal to a percentage of up to 30 percent on "an underpayment of the tax . . . which is *attributable to* a valuation overstatement . . . ." (emphasis supplied). Section 6659(c) defines a "valuation overstatement" as occurring "if the value of any prop-

erty, or the adjusted basis of any property, claimed on any return exceeds 150 percent of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be)."

As this Court has long admonished, "The plain meaning of legislation should be conclusive, except in the 'rare case [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.'" *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989), quoting from *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). This maxim applies with special force to tax statutes where Congress speaks with particular precision. "As we have often said, 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.'" *Malat v. Riddell*, 383 U.S. 569, 571 (1966), quoting from *Crane v. Commissioner*, 331 U.S. 1, 6 (1947).

In interpreting tax statutes, the Court has looked to the relevant definitions of words in the principal standard dictionaries. *Crane v. Commissioner, supra.* By its plain and literal terms, the Section 6659 penalty can be imposed only where the underpayment in tax is "attributable to a valuation overstatement." Here, the standard dictionary definition of the word "attributable" is "capable of being attributed" or "explain[ed] by way of cause." *See* Webster's Seventh New Collegiate Dictionary. Accordingly, the statute prescribes a direct causative relationship between the valuation overstatement and the underpayment in tax as the critical prerequisite for application of the penalty. Thus, if the taxpayer claims an investment credit or depreciation deduction for property with a claimed basis of $150,000 but the correct amount of the basis is only $100,000, the appropriate disallowances will be determined and the penalty will apply. However, if it turns out that the property is not eligible for the credit or the allowance for depreciation, or was not placed in

service during the tax year at issue, the deduction or credit will be totally disallowed. In such a case, the Section 6659 penalty cannot apply because the underpayment in tax is not "attributable to a valuation overstatement" but is attributable to a ground that is independent of the claimed valuation. The correctness of this proposition becomes self-evident if one were to compare the taxpayer's tax liability computed without the improperly claimed deduction or credit with his tax liability computed on the assumption that there was a valuation overstatement. In both instances, the taxpayer's tax liability would be precisely the same. Hence, the underpayment in the case of total disallowance cannot be "attributable to" any valuation overstatement. This interpretation is confirmed by the General Explanation of the Economic Recovery Act of 1981, Staff of the Joint Committee on Taxation, 97th Cong., 1st Sess., at 333 (Comm. Print 1981), a source which this Court has characterized as a "compelling contemporaneous indication" of the meaning of revenue statutes. *Federal Power Commission v. Memphis Light, Gas & Water Division,* 411 U.S. 458, 471-472 (1973).

b. The foregoing analysis of the statutory language of Section 6659 has been endorsed by the Fifth and Ninth Circuits. They have held that where, as here, the Tax Court totally disallows a deduction or credit and where overvaluation is not the direct proximate cause of such disallowance, the Section 6659 penalty cannot be imposed. *Todd v. Commissioner,* 862 F.2d 540 (5th Cir. 1988) (property not placed in service); *Heasley v. Commissioner,* 902 F.2d 380 (5th Cir. 1990) (total disallowance); *Gainer v. Commissioner,* 893 F.2d 225 (9th Cir. 1990) (agreeing with *Todd*). On the other hand, the Eighth and Second Circuits have held that where a transaction is determined to be without economic substance, the resulting underpayment in tax is attributable to an "implicit overvaluation" represented by an overstatement in the basis of property. As a result, these courts have

concluded that a transaction that lacks economic substance necessarily contains an overvaluation statement within the meaning of Section 6659(a). *Massengill v. Commissioner*, 876 F.2d 616, 619-620 (8th Cir. 1989); *Gilman v. Commissioner*, 933 F.2d 143 (2d Cir. 1991), *cert. denied*, —— U.S. ——, 112 S.Ct. 871 (1992).

But Section 6659 does not turn on such catch phrases as "logical reliance" or "implicit overvaluation" that are virtually impossible of predictable application. The penalty therefore cannot be presumptively invoked in every case concluding that a transaction lacks economic substance. The operative statutory term is "attributable," which connotes that the overvaluation must be the direct proximate cause of the underpayment. In the absence of such a finding, the underpayment, as in this case, is necessarily "attributable" to a ground other than a valuation overstatement. As a result, the Section 6659 penalty cannot apply because the taxpayer's tax liability will be exactly the same with or without the claimed overvaluation. Indeed, the Second Circuit in *Gilman* acknowledged as much when it observed that applying the penalty in such a case was "not self-evident" and "somewhat strains the natural reading of the statutory phrase 'valuation overstatement . . .'" (933 F.2d at 150, 151).

Although the foregoing decisional law was called to the attention of the court below, it did not address it. Rather, it purported to follow its earlier ruling in *Illes v. Commissioner*, 962 F.2d 163, 167 (6th Cir. 1992),[6] which upheld the penalty in such a case on the basis of the rationale in *Massengill* and its earlier unpublished decision in *Donahue v. Commissioner*, No. 91-1849 (6th Cir. April 7, 1991). These decisions propose the following test: that where the Tax Court disallows deductions or credits because the transaction lacks economic substance, any finding of a valuation overstatement auto-

[6] *Illes* was originally issued as an unpublished decision. However, the court below ordered that it be published shortly before the oral argument in this case. *See* 982 F.2d at 163 n.1.

matically triggers the Section 6659 penalty. For the reasons discussed above, we do not believe that this rationale can be squared with the statutory term "attributable," the pertinent legislative history, or this Court's strict, *i.e.*, literal, construction of penalty statutes such as Section 6659. As this Court has admonished, the law is settled that " 'penalty statutes are to be construed strictly.' " *Commissioner v. Acker*, 361 U.S. 87, 91 (1959), quoting from *Federal Communications Commission v. American Broadcasting Co.*, 347 U.S. 284 (1954). Thus, one "is not to be subjected to a penalty unless the words of the statutes plainly impose it" *Keppel v. Tiffin Savings Bank*, 197 U.S. 356, 362 (1905). Here, neither the statutory language nor the legislative history can be fairly read to justify the imposition of the overvaluation penalty.

Nor do we believe that *Donahue*, *Illes*, *Massengill*, or *Gilman* articulate a workable and objectively predictable standard for the application of the penalty in these cases. In using the word "attributable" in Section 6659, Congress could hardly have intended that the courts would conduct a subjective inquiry that would impose the penalty whenever the underpayment was either "due in part" to any overvaluation (*Massengill*, 876 F.2d at 620 and *Gilman*, 933 F.2d at 151), where the underpayment was "an integral part" of a conclusion that a transaction lacked economic substance (*Donahue*, slip op. 8), where "[t]he entire artifice . . . was constructed on the foundation of the overvaluation" (*Illes*, 982 F.2d at 167), or where the disallowance was "largely because" of the overvaluation (App., *infra*, p. 5a). Rather, the only practicable meaning of the statutory term "attributable" is to limit the Section 6659 penalty to those instances where the overvaluation is the direct proximate cause of the underpayment. Such a rule would conform to the statutory language and legislative history and pay heed to this Court's teaching that tax penalties be strictly construed.

Here, it is clear that the overvaluation was not the direct proximate cause of the underpayment. The Tax

Court totally disallowed petitioner's claimed investment tax and business energy credits on the ground that the transaction lacked economic substance, business purpose and profit motive. Although it found that the machine was worth approximately $50,000, the Tax Court did not reduce petitioner's claimed credits to conform to its finding as to value. Rather, the Tax Court totally disallowed the credits on the basis of lack of economic substance, business and profit motive.

Moreover, any doubt as to whether petitioner's underpayment in tax is attributable to an overvaluation statement is dispelled by the Tax Court's findings that "[t]wo of the six machines never worked and remained for most of 1981 through 1985 in a PI warehouse" and that "[o]ne machine was sent unsolicited to a company which refused to take the machine and immediately returned the invoice to PI" (App., *infra*, p. 54a). In this respect, the Tax Court further found that "the recyclers were used infrequently and they often were not in use at all" (App. *infra*, p. 31a). Finally, the Tax Court found that "PI failed promptly to pick up . . . the . . . machines rejected by prospective end-users. . ." (App., *infra*, p. 31a). These findings, as affirmed by the court of appeals (App., *infra*, p. 4a), constitute an unquestionably independent basis for disallowance of the credits on the ground that the property was not placed in service because it was not "placed in a condition or state of readiness and availability for a specifically assigned function" Treas. Reg. § 1.46-3(d)(1). In these circumstances, the underpayment in tax is not "attributable" to the valuation overstatement because the direct proximate cause of any underpayment was not a valuation overstatement. By its explicit terms, the Section 6659 penalty is therefore not applicable. *Todd v. Commissioner, supra; Gainer v. Commissioner, supra*; *Heasley v. Commissioner, supra*; *contra, Gilman v. Commissioner, supra.*[7]

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[7] In opposing certiorari in *Gilman* (O.T. 1991, No. 91-642), the Solicitor General took the position that the decision in *Heasley* did

2. The question presented has substantial administrative and continuing importance. While Section 6659 as originally enacted in the Economic Recovery Act of 1981 has been repealed by the Omnibus Budget Reconciliation Act of 1989, the critical statutory language penalizing "any underpayment which is attributable to . . . any substantial valuation misstatement" continues to be employed in the new accuracy-related penalty provision of Section 6662(b)(3) and (e) of the Code.[8] Moreover, we are advised by the Office of the District Counsel of the Internal Revenue Service responsible for the Tax Court litigation of the transaction at issue that approximately 2,500 tax returns claimed precisely the same tax benefits that are affected by the decision below for the tax years 1981 and 1982 and that there are approximately 300

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not conflict with *Gilman*. Seizing upon the fact that the taxpayers in *Heasley* conceded that they were not entitled to their claimed investment tax credit, the Solicitor General claimed that the Fifth Circuit had not directly ruled whether the Section 6659 penalty would apply in a case where the transaction lacked economic substance. We believe that the Solicitor General's argument cannot be reconciled with the Fifth Circuit's broad conclusion that when a credit is disallowed in its entirety, the underpayment is not attributable to the valuation overstatement, but rather "is attributable to claiming an improper deduction or credit" (902 F.2d at 383).

There is, we submit, no meaningful distinction, for purposes of the question of statutory interpretation presented, between the total disallowance in *Heasley* and this case in which a deduction or credit is totally disallowed because the transaction is deemed to lack economic substance. But even assuming *arguendo* the validity of such a distinction, the Solicitor General's Brief in Opposiiton in *Gilman* has already acknowledged the present existence of a conflict. There, he observed (pp. 11-12) that the Fifth Circuit had directly ruled in *Todd* that the Section 6659 penalty could not be applied where, as here, the property had not been placed in service. There is accordingly no question that there is now a square conflict of decisions.

[8] In his Brief in Opposition in *Gilman* (p. 10, n.9), the Solicitor General acknowledged that "[p]rovisions similar to Section 6659 are now found in Section 6662(e), relating to substantial valuation misstatements."

docketed cases in the Tax Court presenting the penalty question in the context of petitioner's investment.[9] If we conservatively assume that approximately 2,000 taxpayers invested an average of $12,500 (one-quarter unit) in identical transactions, the overvaluation penalties plus interest assessed against these taxpayers would total approximately $33 million.[10] Given the Commissioner's position in this test case that was selected to govern the tax treatment of the thousands of taxpayers involved in this investment and the prior and continuing litigation on the penalty question in other transactions, it is fair to assume that there are many other Section 6659 cases presenting this question that are pending administratively and in the courts. Further review by this Court is therefore amply warranted.

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[9] At the trial stage of this case, the Commissioner similarly advised the Tax Court that there were approximately 250 docketed cases and 1,600 undocketed cases involving this transaction (App., *infra*, p. 9a).

[10] We calculate this figure in the following manner. Here, petitioner invested $8,335 ($50,000 × .1667) and was assessed an overvaluation penalty of $4,317. Hence, each dollar invested has resulted in the imposition of an overvaluation penalty of $0.5179. Extrapolating a total nationwide dollar investment of $25 million (2,000 × $12,500) the penalty amount would be $12,947,500. The applicable figure would more than double after the addition of statutory interest.

In July 1993, we filed a Freedom of Information Act request with the National Office of the IRS seeking statistics as to the amount of revenue at stake with respect to the question presented. However, despite repeated requests, the information has not been forthcoming.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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